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NAVAL POSTGRADUATE SCHOOL

Monterey, California



THESIS

OUTSOURCING: AN EXAMINATION OF THE MARINE FORCES PACIFIC COST REDUCTION INITIATIVE

by

Peter A. Grogan

December 1998

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**OUTSOURCING: AN EXAMINATION OF THE MARINE FORCES PACIFIC
COST REDUCTION INITIATIVE**

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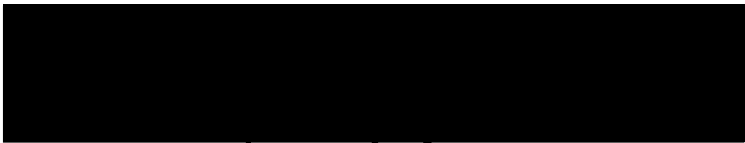
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ABSTRACT

The Department of Defense (DoD) has begun the revolution in business affairs by renewing initiatives for outsourcing as a means to meet an estimated \$60 billion shortfall for force modernization. The Marine Corps has projected outsourcing to achieve \$110 million in annual savings by FY 2004. The Commander, Marine Forces Pacific (MARFORPAC) has designed and is implementing a Cost Reduction Initiative (CRI) to save approximately \$38 million annually by FY 2004. OMB Circular A-76 provides guidance for outsourcing commercial activities. This thesis examines previous DoD experience with outsourcing and the MARFORPAC CRI to determine the lessons learned that may be integrated during implementation of the CRI. This study analyzed outsourcing efforts of other services and developed criteria that may be applied to contracting out services throughout the Marine Corps. Lessons learned include the development of an accurate performance work statement; the use of multifunction studies to provide increased savings compared to several single function studies; the use of best value criteria and a performance-based contract to increase the probability for successful contract awards; command commitment to outsourcing is a key ingredient at the local level; and to keep employees well informed about potential outcomes during the outsourcing process.

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I. INTRODUCTION

A. BACKGROUND

The Department of Defense (DoD) has begun the revolution in business affairs as a result of recommendations by the Quadrennial Defense Review (QDR) and the realization that to achieve the goals of *Joint Vision 2010* DoD must do things differently. Since the end of the Cold War, DoD has experienced declining budgets and an increasing requirement to do more. Since the mid 1980's, DoD has reduced procurement spending by approximately 69%, personnel by 32%, and the overall budget by 35% (Cohen, 1997 and DoD Report, 1996). DoD infrastructure costs continue to absorb a substantial part of the overall DoD budget even though the number of bases have been reduced as a result of the Base Closure and Realignment and Commission (BRAC). DoD officials have begun to look for additional internal ways to save money through infrastructure consolidation and streamlining support functions. (DSB, 1996)

B. RE-EMERGENCE OF OUTSOURCING

Due to recent deficit reduction efforts and competing national priorities for dwindling discretionary funds, defense planners have reassessed the value of outsourcing as a means of reducing infrastructure costs. Numerous studies have looked at potential savings that DoD can achieve as a result of outsourcing. Recent experience with outsourcing indicates that DoD can reduce infrastructure costs by approximately 30 percent. (DoD Report, 1996) The Defense Science Board estimates that DoD can realize

savings of \$7 - \$12 billion by fiscal year (FY) 2002 depending on how aggressive all the services are in outsourcing (DSB, 1996).

The current DoD initiative has been inspired by the fact that savings that result from outsourcing will not be taken out of future years budgets but can be reprogrammed to modernize the force. The anticipated savings from outsourcing will also enable DoD to sustain/maintain the readiness of the force. (DoD Report, 1996)

Federal agencies have been utilizing the private sector for providing services/commercial activities since the mid 1950's. The Office of Management and Budget (OMB) established the federal policy for outsourcing/contracting out with OMB Circular A-76. Over the years, the A-76 process has resulted in cost savings and efficiencies.

1. The Marine Corps Perspective

The Marine Corps' current budget plan has incorporated a \$34 million investment in OMB Circular A-76 studies over the next three years. These studies will determine which functions are eligible for competition. The Program Objective Memorandum (POM) for the Marine Corps reflects a \$20 million competition savings 'ramp'/wedge for FY-1999. This wedge will increase over the next six years to \$110 million by FY-2004. "The wedge was built on assumed savings gained through the competition of all available base commercial activities" (USMC, 1998a). The Marine Corps like the other services, is looking for ways to save Operations and Maintenance (O&MMC) costs that can then be reprogrammed to procurement and modernization of existing systems.

The Marine Corps has emphasized the need to maintain its core warfighting capabilities. As a result, the Marine Corps is focusing outsourcing efforts on outsourcing/competitive sourcing on infrastructure/base commercial activities to generate savings. These savings will be invested in the modernization and procurement accounts. (USMC, 1998b) The goal is to reduce the non-core functions performed by the supporting establishment.

2. Marine Forces Pacific Strategic Plan

The Commander, Marine Forces Pacific (MARFORPAC) has established a proactive Cost Reduction Initiative (CRI) that is intended to meet the assigned wedge to MARFORPAC. The CRI will employ many methodologies to meet the wedge assigned. The CRI is designed to meet the wedge and also provide savings that MARFORPAC can reinvest in its own short fall areas.

The CRI relies on competition from the A-76 process and a program called "Cost Saver". This plan is expected to provide the savings called for in the 'wedge' and more to allow for internal reinvestment.

C. AREA OF RESEARCH AND RESEARCH QUESTIONS

This thesis investigates the cost reduction initiative adopted by MARFORPAC as the Marine Corps and DoD attempt to meet the challenge of reducing infrastructure costs while maintaining readiness in an era of reduced resources.

1. Primary Question

The primary questions addressed in this thesis are: (a) What is the Marine Corps policy on outsourcing, (b) what are the lessons learned from commands that have

completed the outsourcing process, and (c) is the strategy developed by the Commander, Marine Forces Pacific adequate to achieve the savings that have been identified by HQMC.

2. Secondary Question

In answering the primary question, the following secondary questions will be addressed:

1. What is the definition of outsourcing?
2. What are the strengths and weaknesses of outsourcing?
3. Why does the Marine Corps need to outsource?
4. Why does the Commander, Marine Forces Pacific need to outsource?
5. What are some of the issues that will affect the Commander, Marine Forces Pacific during the outsourcing process?
6. What types of impact can the Marine Corps and Commander, Marine Forces Pacific anticipate as a result of outsourcing?

D. SCOPE

This thesis will focus primarily on one major component of the Marine Corps, MARFORPAC. MARFORPAC is headquartered in Hawaii and maintains bases in the United States and overseas. This thesis will:

1. explore the outsourcing initiative developed by MARFORPAC;
2. identify possible problem areas that may arise as a result of the cost reduction initiative;
3. identify concerns with the outsourcing process based on opinions of personnel involved with the process;
4. compare the MARFORPAC initiative with other Department of the Navy outsourcing initiatives.

Because the MARFORPAC plan is in its initial stages, a cost comparison will not be able to be completed due to time limitations.

E. METHODOLOGY

A thorough review of government reports, congressional testimony, and a wide variety of references, was conducted to gather historical and current data. Interviews were conducted with the MARFORPAC Cost Reduction team to provide expert opinions on the process being used.

Chapter II focuses on the background of outsourcing and specific areas related to DoD. Chapter III examines the MARFORPAC CRI initiative. An analysis of other DoD outsourcing experiences and related lessons learned is provided in Chapter IV. Chapter V discusses conclusions, answers the thesis questions, and provides recommendations for further research.

F. BENEFITS OF RESEARCH

This thesis will provide an initial assessment of the MARFORPAC CRI initiative. This assessment will provide MARFORPAC and other commands an overview of lessons

learned from other DoD outsourcing initiatives and how they will impact the implementation of the CRI.

II. BACKGROUND OF OUTSOURCING

A. INTRODUCTION

During the Eisenhower administration, the president signed a presidential directive stating that "the federal government will not start or carry on any commercial activity to provide a service or product for its own use if such a product or service can be procured from private enterprise" (Hanke, 1987). OMB Circular A-76 instituted a formal policy for commercial activities in 1966. Since that time, DoD has utilized this policy as a management tool to outsource commercial activities.

The emphasis on outsourcing or competitive sourcing has increased within the past few years as a result of numerous studies conducted by the administration and DoD (GAO 96-108). These studies have indicated that substantial savings can be achieved through outsourcing commercial activities. During this period of fiscal constraint, DoD has utilized procurement and modernization accounts to fund shortfalls in the operation and maintenance accounts. This strategy worked initially due to the reduction in end strength and the relatively new age of most weapons systems. "The QDR report noted that while DoD had reduced active duty personnel by 32 percent between 1989 and 1997, it had only reduced the number of personnel performing infrastructure functions by 28 percent" (GAO 98-122). Today, DoD faces the challenge of reinvesting in procurement and modernization while maintaining operations and maintenance to meet current and future threats.

B. OUTSOURCING DEFINED

Outsourcing or contracting out has been given many definitions throughout the years. "DoD defines outsourcing as the transfer of functions performed in-house to outside providers and privatization as the transfer or sale of government assets to the private sector"(GAO 97-110).

The underlying assumptions of outsourcing are that (a) the government operates as a monopolist and is therefore inefficient, and (b) the private sector is inherently more efficient because of competition in the market. Osborne and Gaebler indicate that the key is not public versus private, but the presence of competition. (1993, p. 79)

This thesis focuses on outsourcing and considers outsourcing, contracting out, and competitive sourcing to mean the process of transferring functions that are traditionally done in-house to the private sector.

The key to outsourcing is infusing competition into those functions that have been accomplished previously by government agencies. It is assumed that competition leads to increased efficiencies and savings. A recent Center for Naval Analysis study indicated that average savings of 30 percent could be realized from outsourcing (Tighe, 1996).

Outsourcing in the private sector has become the model for DoD to emulate. The Outsourcing Institute estimates that in 1996, U.S. firms spent approximately \$100 billion for outsourced services while saving 10 to 15 percent of total costs. In a 1995 survey, firms viewed outsourcing as a means to reduce costs and stay competitive. (DSB, 1996) The Defense Science Board also identified key outsourcing lessons learned from the private sector that covered management, contracting, and personnel.

OMB Circular A-76 is official government policy stating that Federal Agencies are to rely on and not compete with the private sector for goods and services. This policy has evolved over the years to reflect the assumption that the government should obtain goods and services in the most cost-effective manner.

C. RE-EMERGENCE OF OUTSOURCING

With the end of the Cold War DoD has experienced budget reductions that rival the worst of times in the past Cold War era. To maintain readiness, money was transferred from procurement and modernization accounts. Due to recent budget reductions and the balanced budget agreement, top-line defense budgets are not anticipated to grow significantly in the out-years. Since the mid 1980's, the defense budget has declined approximately 60 percent in real dollar terms. (DRI, 1996)

As a result of this current fiscal reality, DoD has embraced outsourcing and privatization as a means to save money. The Commission on Roles and Missions (CORM) made this recommendation in its 1995 report:

We recommend that the government in general, and the Department of Defense in particular, return to the basic principle that the government should not compete with its citizens. To this end, essentially all DoD "commercial activities" should be outsourced, and all new needs should be channeled to the private sector from the beginning. (CORM, 1995, p.3-3)

1. Steady State Budget

As previously stated, in FY 1997 the defense budget reflected a 60 percent decline in real terms from its Cold War peak in 1985. This fact, coupled with the commitment to reduce the federal deficit, means that DoD cannot plan on an increase in its budget. As a result, the recommendation of the QDR to increase modernization funding to \$60 billion

will have to be paid by increasing internal efficiencies. These efficiencies will have to come from infrastructure savings.

DoD has renewed efforts to achieve savings by utilizing the A-76 process. As a result of the QDR, CORM, and DSB, the Department has set an aggressive plan in motion to achieve savings required by the QDR. Some of the savings proposed are:

- By 2003, DoD anticipates saving over \$2 billion annually from outsourcing commercial activities that involve over 130,000 civilian personnel
- The CORM recommended outsourcing or privatizing all current and newly established commercial type support services, which could save over \$3 billion per year.
- The DSB recommended restructuring the DoD support structure and relying on the private sector. This along with the adoption of better business practices could save over \$30 billion annually by 2002.
- The QDR recommended cuts of 61,700 active duty personnel, 54,000 reserve personnel, and 60,800 civilian personnel by 2003. These cuts are expected to save \$3.7 billion per year by 2003 (GAO 97-110 & 98-100).

If achieved, these savings will provide resources needed to modernize the force, meeting the \$60 billion goal.

2. Focus on Core Competencies

Since 1996, DoD has begun to evaluate in-house activities that do not directly relate to meeting national security needs. The QDR estimated that \$10 to \$12 billion in procurement funding could be diverted for unplanned operating functions if DoD maintains the status quo (GAO 98-100). Expanding outsourcing of commercial activities will assist DoD in adjusting to a declining defense budget and a changing world environment while ensuring and adequate national defense.

Public sector core competencies may be defined as those activities that are inherently better done by governmental agencies than business. These are activities that, for legal, constitutional and other reasons would be inappropriate to relinquish responsibility for to a non-government source (Camm, 1996). DoD has identified three major areas that must be maintained to meet the security challenges of the future: 1) readiness; 2) quality of life; and 3) modernization. "The purpose of the departments initiative is to sustain or improve readiness, generate savings for modernization and improve the quality and efficiency of support to the warfighters" (DoD Report, 1996). By competing base infrastructure functions, DOD's warfighting competencies are left intact and perhaps strengthened.

3. Benefits of Outsourcing

The proponents of outsourcing cite a number of benefits. First, as noted, competition for services will result in greater efficiencies. These efficiencies will result whether a public or private enterprise conducts the activity (Tighe, 1996).

Second, the economic benefits that result from competition translate into cost savings. The savings from contracting out to a private firm can be substantial because the private firm has a powerful incentive to seek innovative approaches to reduce costs (Hanke, 1987).

a) Efficiencies

Competition and profit incentives are far stronger efficiency tools than bureaucratic management tools (Fitzgerald, 1988). The outsourcing process provides opportunities to increase efficiency within the organization. The A-76 process provides

guidelines for the development of most efficient operations. The competition that results is presumed to drive the organization to increase efficiency.

Outsourcing provides the government the opportunity to take advantage of the efficiencies of the market. Since the private sector is driven by the profit motive, the private sector is supposed to be more receptive to customer needs. The private sector can also take advantage of labor efficiencies and economies of scale. Labor efficiencies result from the greater flexibility private firms have in managing the work force. Economies of scale also result, in some instances, from the fact that a private firm can perform the same function at multiple sites. (Robert, Gates, & Elliot, 1997)

Competition also leads to an increase in productivity. Numerous studies indicate that productivity increased as a result of A-76 reviews. The increase in productivity results from realizing economies of scale, utilizing improved production equipment and reorganizing structure and operating procedures (Hilke, 1992). Competitions associated with the A-76 process force in-house activities to streamline their operations and cut costs below the level that existed prior to study (HASC, 1989).

b) Cost Savings

The primary focus of outsourcing is projected savings. The competition associated with outsourcing can provide alternative sources of supply, introduce cost visibility and better business practices. (Tighe, 1996)

Between 1978 and 1994 DoD conducted over 2,000 A-76 competitions that resulted in savings of \$1.5 billion (DSB, 1996).

	Competitions Completed	Average Annual Savings (\$M)	Percent Savings
Army	510	\$ 470	27%
Air Force	733	\$ 560	36%
Marine Corps	39	\$ 23	34%
Navy	806	\$ 411	30%
Defense Agencies	50	\$ 13	28%
Total	2,138	\$1,478	31%

Table 2-1. Savings Yield from Competition (DRI, 1997)

As Table 2-1 indicates, savings were realized during these competitions, resulting in reduced operating costs. These savings highlight the future potential of outsourcing. Other studies indicate that projected savings from outsourcing can range from 20 to 40 percent. Among actual competitions, approximately 50 percent were won by in-house government agencies. (GAO 97-86) The key to achieving these savings was competition and not the outsourcing of the activity itself.

Based on recent studies, historical evidence and the proposed A-76 competitions scheduled within DoD, it is estimated that DoD can save \$6 billion over the next five years. The goal is to achieve annual savings of \$2.5 billion per year beginning in FY 2004. (DRI, 1997)

Competition from outsourcing provides DoD with a means to capture some of the benefits of the market economy regardless of who wins the competition. The resulting organization will be more adept at meeting the challenges of an uncertain world. The benefits from competition will allow DoD to better provide the nation with the military force needed for the 21st century. (DRI, 1997) In the final analysis, the government is responsible to the taxpayer to ensure that the competitive process is managed fairly and cost effectively.

4. Outsourcing Concerns

With any program, policy or initiative, there are advantages and disadvantages to be considered. Concerns with outsourcing have been raised by opponents. The following three are prevalent in the literature: 1) projected savings are overstated; 2) fraud and abuse is associated with contracting services; and 3) there is cultural resistance to this type of change.

a) Projected Savings May Be Overstated

As a result of the savings projected from outsourcing, DoD has reduced out year O&M budgets. Several GAO reports caution that past experience has shown that actual savings have fallen short of forecasted amounts (GAO 97-110, 98-86, & 98-122).

Previous experience within DoD with reform initiatives has not resulted in the amount of savings initially estimated. Part of the problem is quantifying cost savings. This is due in part to a lack of accurate cost data within DoD and OMB. Another factor is the inherent inaccuracy of the DoD commercial activities database. This database provides operational savings that represent the difference between the cost of the in-house activity and the cost of the winning bid under A-76 competitions. The military departments (mildeps) and services track these costs for only three years. Any changes that occur after three years are not tracked. Many studies have forecasted savings based on information in this database. Consequently, the conclusions drawn with regard to the amount of savings that can be achieved is suspect. (GAO 97-86)

With the potential for future budget and personnel reductions, the potential to achieve the proposed savings is slowly reduced. During FY 1987 through FY 1996, O&M budget authority declined by 25 percent in real terms and the civilian work force

declined by 27 percent, and it is expected to decline by 33 percent by FY 2002. (GAO 97-86) As a result, many of the easy savings have been achieved. To maintain the current level of support to the force, the scope of work for contracts will have to be increased, thereby increasing the costs to accomplish the activity and reducing the savings realized.

b) Fraud and Abuse Associated with Contracting

Contractor abuse is not unique to the government. Fraud also occurs within the private sector. The difference is that when it is uncovered in a government contract, it is more visible. Contractual problems are typically the result of flaws in the development of the performance work statement. Congressional testimony has highlighted cases where contractor corruption has occurred (HGR&O, 1997). This can be resolved in part by establishing more clearly defined service requirements, written evaluation and monitoring criteria (Hanke, 1987). Having a good and enforceable contract reduces the potential for abuses.

Contractor corruption is difficult to achieve when the process meets four criteria: 1) bidding is competitive; 2) the competition is based inaccurate cost information and quality performance criteria; 3) the contract has a built in monitoring system; and 4) an outside party is charged with performing these tasks (Osborne and Gaebler, 1993). To prevent abuse, the government employs a three-phase strategy: 1) utilization of accurate statements of work; 2) conducting random audits on contract and in-house work performance; and 3) contracts are recompeted if performance is substandard (HGR&O, 1997). By adhering to this strategy, DoD is able to prevent some fraud. However, DoD must be ready to detect fraud when it occurs or face the wrath of Congress and the public.

c) Cultural Resistance to Change

For outsourcing to be successful, the culture within DoD must change. The DRI established the framework for such change. The Secretary of Defense has established the Defense Management Council to oversee the implementation of this change within the Department. (DRI, 1997)

DoD is in the process of transforming from a Cold War response organization into one that meets the challenges and unpredictability of the future. The lack of common systems and processes across the mildeps and services create problems in implementing change. The Defense Management Council is supposed to enforce greater commonality for the mildeps and services.

To achieve success, DoD must ensure that implementation is based on results-oriented goals, performance measures and a realistic implementation timetable. The Defense Management Council must take an active role in this process and communicate it to the mildeps and services. This will then allow the mildeps and services to focus resources on higher priority programs.

D. THE OUTSOURCING PROCESS

The decision to outsource functions is seldom easy to make in the public or private sector. OMB Circular provides guidelines for agencies to determine activities that are commercial in nature. Commercial activities are defined as those providing a product or service that can be obtained from a commercial source (DoD,[4100.15], 1989). The General Accounting Office (GAO) has submitted many reports to Congress on OMB

Circular A-76. The following summary from one such report provides background information on the process.

Circular A-76 and its supplemental guidance require agencies to evaluate their activities to determine whether they are governmental or commercial and complete an inventory of all commercial activities. A-76 requires, in certain circumstances, that agencies conduct cost comparisons to determine the most efficient means to carry out commercial activities. Under A-76, agencies are to use a three-step process to determine whether recurring commercial activities will be performed in-house or by contractors. The process consists of (1) developing a performance work statement that defines the technical, functional, and performance characteristics of the work to be performed; (2) conducting a management study to determine organizational structure, staffing, and operating procedures for the most efficient and effective in-house performance of the commercial activity, referred to as the Most Efficient Organization or MEO; and (3) accepting formal bids and conduct a cost comparison between the private sector and the government's Most Efficient Organization in order to make a decision on whether an activity will be performed by the government or the private sector. (GAO 98-146, pp.2-3)

The A-76 process has resulted in savings. Some agencies report that savings resulted from the competition resulting from the use of the process while GAO reports that savings from the A-76 process were the result of reengineering the activity resulting in fewer personnel. It is evident that savings can be realized when agencies utilize a structured approach to review their procedures and to implement changes that result in a more efficient organization.

Besides the savings that can result, the A-76 process also may provide an effective management tool to increase efficiency within the organization. A-76 gives agencies the ability to make more business-like decisions that lead to better performance. The A-76 process is the vehicle that allows for competition between the public and private sectors. It forces public sector organizations to evaluate organizational processes and develop the

MEO that can provide efficiencies and cost savings. It also provides an opportunity for the private sector to compete against public organizations.

The A-76 process is not without its critics. One of the major complaints with the process is that it is lengthy and disruptive. The reason for this stems from the fact that the in-house agency must develop historical data to conduct an accurate cost comparison while at the same time continue to conduct normal business. This puts managers and workers in the position of analysts, which may lead to confusion and a decrease in productivity. (HGR&O, 1995) The process currently averages two years to complete. This causes internal problems with the agency as workers feel added stress not knowing the status of their future employment.

Another concern is that the process is implemented unevenly within the government. DoD has led all other governmental agencies in the number of cost comparison studies conducted since FY 1986 (HGR&O, 1997). DoD has one of the largest pools of federal civilian workers so there is an incentive within DoD to conduct A-76 studies in the hopes of realizing savings. However, even within DoD there are legislative restrictions on the type of activities that can be subject to the A-76 process. These restrictions exist because of legislation that: a) require studies and Congressional notification prior to converting public activities to contractors where more than 45 civilian employees are involved; b) restricts the mildeps and services from contracting out firefighter and security guards; c) requires the mildeps and services to maintain a logistics capability sufficient to provide a timely response to mobilization or other national defense emergency; and d) requires the mildeps and services to submit annual reports to Congress. (GAO 97-110 & 98-48) These statutory and regulatory provisions act as

hindrances to the mildeps and services as they attempt to achieve efficiencies and reduce costs. Some examples of these restrictions are:

- DoD is required to have 60 percent of all depot maintenance performed by federal employees.
- The mildeps and services must determine which logistics functions are core warfighting capabilities and maintain these under direct control.
- Firefighting and security guard functions must be performed by federal employees even in those areas where these functions could be performed more efficiently by the private sector. (DoD Report, 1996)

As a result, DoD is forced to concentrate on those commercial activities that relate to supporting the force.

E. THE MARINE CORPS PERSPECTIVE

The Marine Corps presently faces unique challenges in managing the transition to the 21st century. These challenges are manifest in the need to modernize aging weapons systems and facilities in an era of reduced resources. To meet these challenges, the Commandant has called for a, "Revolution in Business Affairs" that will drastically change the way the Marine Corps conducts business (CMC, 1998). The Marine Corps, like the other services, has sustained operations and maintenance funding at the expense of procurement. "Based on the most optimistic economic assumptions, and assuming the [Advanced Amphibious Assault Vehicle] AAV enters procurement in FY 2004, the Marine Corps is at least \$1 billion short of affording the Corps we need" (Fulford & Clifton).

As a result of the movement of funds from investment into O&MMC accounts, the Marine Corps also faces a backlog of maintenance on its real property. Currently, the Marine Corps is investing in military construction that replaces existing facilities on a cycle of 200 years. (Fulford & Clifton) Clearly, this is inadequate to meet the needs of the Corps. In FY 1999, the backlog is expected to grow to \$814 million, based on the current assumptions about FY 1999 budget (HNSC, 1998). The Marine Corps, like the other services, has been assigned its portion of the \$60 billion DoD savings 'wedge'. Figure 2-1 depicts the Marine Corps savings wedge.

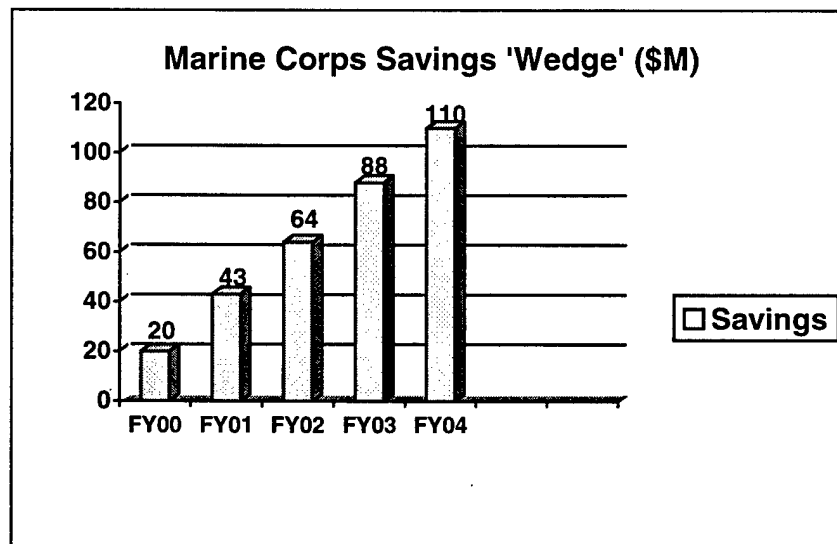


Figure 2-1. Marine Corps Savings Wedge (USMC, 1998a)

The Marine Corps has spread the wedge over major commands and bases. As indicated in Figure 2-1, the Marine Corps must identify \$20 million in savings by FY 2000. Each commander is tasked with identifying functions that can be competed. Attaining these savings will require innovative approaches to obtain the best value for goods and services. To attain the efficiencies needed to support this savings effort, the

Marine Corps will contract out active duty Marine billets that do not affect core competencies and reduce end strength (USMC, 1998a).

F. SUMMARY

DoD must continue to reduce its infrastructure costs to increase funding for modernization. Outsourcing is believed to be the tool that will attain the savings needed. Previous experience has shown that the competition associated with the outsourcing process can generate savings and improve performance.

The savings anticipated from the A-76 may not be realized. To attain the savings needed for modernization, the mildeps and services must ensure that the performance work statements are accurate and that the statements of work accurately depict the services required.

The Marine Corps has begun the long-term effort to streamline its infrastructure. To be successful in this endeavor, the Corps must have leaders who embrace the concept and are willing to 'think outside the box'.

III. MARFORPAC CRI

A. INTRODUCTION

MARFORPAC has developed and instituted the Cost Reduction Initiative (CRI) to meet the challenges associated with competitive sourcing. This plan distributes MARFORPAC's portion of the Marine Corps wedge to its major subordinate commands. Figure 3-1 depicts MARFORPAC's portion of the wedge. The cumulative effects of the wedge can be seen as MARFORPAC will 'contribute' \$150 million to the Marine Corps savings wedge between FY 2000 to FY 2005.

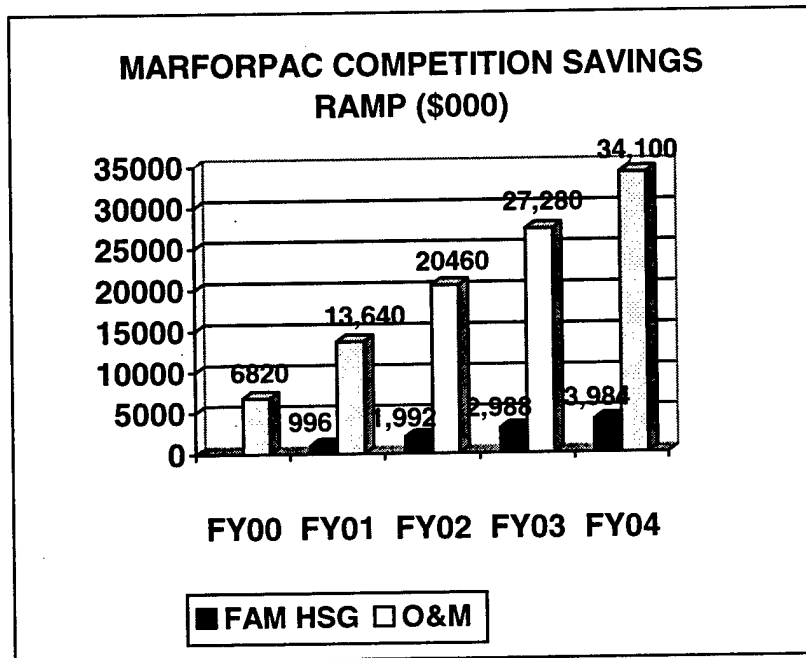


Figure 3-1. MARFORPAC Savings Wedge (USMC, 1998a)

The focus of the CRI is directed at the core business functions that MARFORPAC conducts. MARFORPAC has adopted a two pronged strategy to achieve these savings

because of the impact of overseas installations. For U.S. installations, the OMB Circular A-76 process will be the primary tool used to achieve savings. For the WESTPAC installations, commands will utilize the cost saver process because the government of Japan pays most of the base labor and utility costs. The cost saver process will also be used by the operating forces to realize savings and efficiencies because their functions are inherently governmental. (MARFORPAC, 1998c)

Table 3-1 depicts how MARFORPAC has distributed their wedge between the MARFORPAC commands. The amounts shown will be withdrawn from the command's budget ceiling on 1 October of the fiscal years indicated. This table also indicates the number of commercial activity billets that each command will compete. Billet targets appear in the FY in which savings will be withdrawn.

	FY 00	FY 01	FY 02	FY 03	FY 04	FY 05
<u>CAMP BUTLER</u>						
WEDGE(\$M)	3.2	6.4	6.4	6.4	6.4	6.4
BILLET TARGETS			960	960	960	960
<u>IWAKUNI</u>						
WEDGE (\$M)	1	1.9	1.9	1.9	1.9	1.9
BILLET TARGETS			290	290	290	290
<u>I MEF</u>						
WEDGE (\$M)	2	3	4	4.5	5	7.3
<u>III MEF</u>						
WEDGE (\$M)	1	1.5	2	2.5	3	4.8
<u>COMCABWEST</u>						
WEDGE (\$M)	0.45	1.5	3.7	4.3	4.3	4.3
BILLET TARGETS			600	600	1300	1300
<u>CAMPEN</u>						
WEDGE (\$M)	1.8	3.6	4.7	5	5	5
BILLET TARGETS			2000	2000	2000	2000
<u>MCB HAWAII</u>						
WEDGE (\$M)	0.9	1.1	1.1	1.1	1.1	1.1
BILLET TARGETS				700	700	700

Table 3-1. MARFORPAC CRI Savings Wedge (MARFORPAC,1998b)

B. THE CRI

The CRI is a long-term program designed to meet mandated savings and investment requirements. This will require a cultural change within MARFORPAC as to how the command plans programs and budgets. This plan also requires the commitment of leaders at all levels of command. The Force Commander has articulated his vision to the force:

U.S. Marine Forces Pacific/Marine Corps Bases Pacific will be proactive in cost reduction efforts to support funding of force modernization and reinvestment in our own shortfalls. We will create processes and a structure to support our operating forces—processes and structure that work better and cost less. Our end state will be the savings of 10 percent based on FY99 ceilings for FY03 and the outyears, while maintaining (or increasing) Readiness and Quality of Life. **Our first priority will always remain to ensure that our operating forces are ready to fight!** (MARFORPAC,1998a)

The CRI effort is based on the following principles established by the Force Commander:

- Meet the wedge while maintaining - or increasing- readiness and quality of life.
- Mobilize, motivate and enable commanders to reduce costs and meet assigned wedges using a variety of cost saving tools.
- Utilize a 'combined arms' approach to cost savings - the operating forces and supporting establishment will both participate in the CRI.
- Utilize a bottom-up approach - all levels of command must participate in order to identify and implement the best business practices and policies.
- Use all cost savings tools available, but focus on those primary tools tailored to the geographic region and organizational structure.
- In the midst of change the philosophy of taking care of our people will not be abandoned.

- All commercial activities will be competed - this competition does not imply that the function will be outsourced. (MARFORPAC, 1998a)

1. CRI Organization

MARFORPAC has developed a four-tier organization to implement the CRI. The organization is made up of the CRI Executive Steering Committee (ESC), the CRI Working Group, the MARFORPAC G-8 Cell, and the Installation/MEF CRI Cells.

a) The Executive Steering Committee

The ESC is made up of general officers representing all major commands within MARFORPAC. Its primary role is to provide oversight and long range guidance for the CRI, provide recommendations to the Force Commander, and task the Working Group. The ESC will also interface with the Headquarters Marine Corps (HQMC) Outsourcing and Privatization Executive Steering Committee. The Deputy Commander chairs the MARFORPAC ESC. (MARFORPAC, 1998a)

b) The CRI Working Group

The MARFORPAC Assistant Chief of Staff, G-8, chairs this group. Representatives include members of the MARFORPAC staff and members of the subordinate MEF's and installations. The Working Group's role is to develop working-level plans and requirements and discuss issues related to on-going commercial activity studies. (MARFORPAC, 1998a)

c) The MARFORPAC CRI Cell

Members of the MARFORPAC G-8 comprise this cell. Included with the active duty Marines are three Industrial engineers and a civilian contractor. The CRI cell

will implement the approved guidance of the ESC, and provide information and assistance to subordinate commands. (MARFORPAC, 1998a)

d) Installation and MEF CRI Cells

These cells will implement the CRI at the local level. Each command is given flexibility to establish the cell according to the specific needs of the command. Each cell will be responsible for coordinating between the supporting establishment and the operating forces. (MARFORPAC, 1998a)

MARFORPAC has also established a working relationship with the Navy Facilities Engineering Command (NAVFAC) to provide expertise in areas where the Marine Corps is lacking. These Industrial Engineers have become integral members of the MARFORPAC staff and provide expertise on the OMB Circular A-76 process, cost reduction and program analysis. Currently four have been assigned to the MARFORPAC CRI cell and re-named Re-Engineering Business Consultants.(RBCs) The goal is to have 13 RBCs working with each installation and the MEFs within the year. (Fulford & Clifton) This CRI organizational structure is designed to effectively implement and monitor the CRI program.

2. Competitive Sourcing

The primary cost saving tool for U.S. installations will be the OMB Circular A-76 process. Under the MARFORPAC CRI plan, the A-76 process is expected to average 24 months to complete. The following policy statements regarding competitive sourcing have been published:

- All installation billets will be considered commercial activities unless otherwise justified in accordance with OMB Circular A-76.

- All commercial activities will be competed.
- U.S. installations shall use combined function studies to conserve resources, facilitate post-competition oversight and ensure strong competition.
- WESTPAC installations shall achieve the maximum reduction in labor costs.
- Reductions in installation military manpower costs will count towards the modernization wedge.
- Personnel will be trained to effectively engage in competition.

(MARFORPAC, 1998b)

MARFORPAC anticipates conducting multi-function studies at its U.S. installations. Reductions in personnel, both military and civilian, will create challenges that will need to be overcome. These challenges include transition plans, sea-shore rotation plans and Military Occupational Specialty (MOS) progression. Details of how to effectively meet these challenges are still being formulated. The reductions in the O&MMC accounts begin in FY 2000; therefore solutions to these challenges will be dealt with during the A-76 process.

a) A-76 Guidebook

MARFORPAC will utilize the Navy's *Succeeding at Competition: Guide to Conducting Commercial Activity Studies* to provide commanders with a tool to assist them in navigating the issues associated with the A-76 process. This guide provides a 15-step process to complete the process in accordance with the intent and requirements of OMB Circular A-76.

This guidebook outlines a process that provides detailed timelines and milestones so that the process can be completed within 12 months. The steps are:

- Step 1: Plan for Commercial Activities Study
- Step 2: Develop PWS and Quality Assurance Surveillance Plan (QASP)
- Step 3: Review and Revise PWS and QASP
- Step 4: Obtain Higher Level Approval of PWS and QASP
- Step 5: Conduct Presolicitation Actions
- Step 6: Prepare and Issue Solicitation
- Step 7: Develop the Management Plan
- Step 8: Respond to Solicitation (Government/Contractor)
- Step 9: Perform Independent Review
- Step 10: Evaluate Proposals
- Step 11: Obtain Prenegotiation Clearance Approval
- Step 12: Conduct Discussions with Offerors
- Step 13: Obtain Final Clearance Approval for Best Value Contractor Proposal
- Step 14: Compare Government and Contractor Proposals
- Step 15: Announce Tentative Decision

3. Other Cost Saving Initiatives

The Cost Saver program is designed for overseas installations and the operating forces. The program utilizes a constructive team approach to identify, evaluate, develop and implement better, more efficient business practices. It focuses on streamlining and re-structuring organizations to achieve a 'most efficient organization'. Cost Saver is a four phased process consisting of: Initial Contact, Training, Development, and Implementation. This is a team-oriented approach that recognizes the benefits of employee/staff involvement. Cost Saver will focus on the following base and operating forces business practices: contract improvements, process improvements, developing and expanding business opportunities, and organizational changes. The key to the process is having strong leadership and the involvement of the employees.

MARFORPAC will develop Activity Base Costing (ABC) capability as a means to determine the total costs associated with various activities. ABC also will be used to conduct functional cost analysis, develop a scorekeeping baseline and measure the

success of the CRI. MARFORPAC has committed \$527 thousand for training in ABC. ABC will also be used in the Cost Saver process. (MARFORPAC, 1998c)

Regionalization or consolidation of functions between installations also is being considered. This concept ranges from functions that are shared by installation in the same geographic area, logistics and manpower, to functions that are conducted by commands in different geographic locations. Interservice regionalization is also being explored. The goal is to eliminate redundant functions and organizations, and streamline the remaining functions and organizations, thereby reducing overhead costs. (MARFORPAC, 1998c)

Adoption of better business practices also is part of the overall CRI. Benchmarking and modeling current practices on established and proven private enterprise practices will be attempted. In addition to ABC, this will include outcome-based contracting and streamlined acquisition. (MARFORPAC, 1998c)

4. Scorekeeping

MARFORPAC has developed a model designed to provide accounting of investments, maintain an accurate record of savings achieved and support economic analysis. The model is based on the Standard Accounting, Budgeting and Reporting System (SABRS). SABRS will record funding reductions made in the same expense category in which savings have been identified.

The scorekeeping model is based on funding levels as of 1 October 1998. Changes to the funding level as a result of congressional, DoD or service action will require the model to be adjusted.

Savings that result will be applied using the following priority: funds to meet MARFORPAC's assigned portion of the Marine Corps modernization wedge; funds

allocated by the MARFORPAC ESC towards CRI investment, civilian transition, and installation and operating force deficiencies; and funds retained by the local commanders as efficiency incentives. (MARFORPAC, 1998c)

The scorekeeping model will assess success in three parts. Part one will assess the changes in spending patterns of the major subordinate commands (MSC). A series of reviews will be conducted to evaluate actual obligations recorded in official accounting reports. These data will then be analyzed by the MARFORPAC CRI cell to measure spending changes in core functions. These data will be arrayed in the Core Business Model format depicted in the Appendix. The Appendix illustrates the Core Business Model for bases/stations and the operating forces broken out by functional area. The CRI cell assessment will then be compared to the savings reported by the MSCs, and differences will be reconciled as necessary.

Part two will assess changes in readiness reported by the MSCs. Standard readiness reporting criteria will be utilized for bases/stations and the operating forces. Data will be analyzed to determine whether readiness has declined, remained the same or improved during the CRI period.

Part three will assess changes in Quality of Life (QOL) of each of the MSCs. Standardized QOL indicators will be used as outlined in various directives for bases/stations and the operating forces. These data will be analyzed to determine trends in QOL and to evaluate whether QOL has declined, remained the same or increased during the CRI period. (MARFORPAC, 1998c)

MARFORPAC has developed a broad-based approach to achieving the assigned savings. The command will employ many cost saving measures ranging from better

business practices to elimination of unnecessary functions and competing all commercial activities. MARFORPAC has recommended to each command that all commercial activities be competed in a single function study as a means of conserving resources. While specific savings from the A-76 competitions will not be known for more than two years, utilizing the other cost saving measures will result in near term savings. With the implementation of the CRI, MARFORPAC is breaking new ground for the Marine Corps.

IV. CASE STUDIES AND ANALYSIS

A. INTRODUCTION

Each outsourcing initiative is unique and must be evaluated on a case by case basis due to the fact that each installation has a unique mission. When determining which function to outsource, many considerations impact the decision. Potential commercial activities may be similar across installations; but to ensure competition the functions must be available in the private sector. This requires the availability of alternate providers from which the installation may choose.

For savings to be generated from competition, there must be a viable local market for that service. The more competitors in the market, the more likely it is that costs will be controlled over time. With more competitors in the market, the contract will continue to bid upon when it is recompeted, thus ensuring that the best price is paid for the service.

Another consideration is to determine how to effectively separate functions without disrupting the mission of the installation. Bundling or grouping similar functions together can provide efficiencies and cost savings. These efficiencies arise because the installation only has to deal with one contractor. Cost savings occur as a result of fewer resources applied to conduct a cost comparison study. A drawback to bundling is that the installation may have to accept some inefficiency in a part of the overall contract so as not to put the entire contract at risk.

DoD has a wealth of experience in outsourcing; from building major weapons systems to contracting out base support services. Some experiences, both positive and negative are evaluated in the following section.

B. OUTSOURCING CASE STUDIES

The following case studies provide experiences from other services that MARFORPAC can utilize when implementing the CRI. The specific functions outsourced may not apply to MARFORPAC; the lessons learned can provide a wealth of valuable knowledge.

1. Fort Rucker

Fort Rucker is the main aviation-training base for the U.S. Army. The Army has contracted out the maintenance of training helicopters and primary flight instruction for over 30 years. The aircraft maintenance contract is a cost-plus contract with incentives because the Army is more concerned with safety issues. The current contract is worth approximately \$80 million and is recompeteted every five years. During the last competition there were 15 bidders. Although different contractors have won over the years, the employee base has remained in place resulting in steady performance. (Tighe, 1997)

The pilot training contract provides instruction for 22 weeks of primary flight instruction. This includes classroom and flight training. The command is very satisfied with the quality of the output - the basic helicopter pilot. The contract allows for a flexible response to training requirements. The command is required to give a 60-day notice for an increase in instructors and 30 days when fewer instructors are needed. This

flexibility has not adversely impacted the contractor performance. As an example, during the only contract default, the instructors continue to work without pay for one week until a new contractor was chosen. (Tighe, 1997)

The renewed emphasis on outsourcing is creating similar challenges for Fort Rucker as currently seen by MARFORPAC. Fort Rucker currently lacks the expertise to conduct A-76 cost comparison studies, create the PWS and design the MEO. Due to this lack of experienced personnel, the command is reluctant to initiate new A-76 studies. The command also faces pressure from the Army chain of command to find additional outsourcing savings. Fort Rucker staff members have questioned whether additional savings can be found as a result of downsizing and fiscal constraints. (Tighe, 1997)

2. Navy TA-4 Maintenance

The Center for Naval Analysis (CNA) conducted a study of the outsourcing of maintenance for the TA-4J Skyhawk aircraft, at Navy advanced jet training commands. CNA wanted to determine whether training readiness had been affected as a result of the switch to contract maintenance.

CNA developed five lessons learned from their case study. The first is that there was a significant break-in period or learning curve associated with beginning of the initial contract. Performance dropped during this period. The transition period lasted four years and it took two years before the contractor realized any performance improvement compared to in-house Navy maintenance. Even with this initial degradation in performance, the quality of the maintenance and readiness was not adversely affected in the training commands. (Tighe, 1997)

Second, after the initial break-in period, the contractor performed as well as, or better than the in-house Navy maintenance. By analyzing aviation maintenance data for mission capable (MC) and full mission capable (FMC) rates, CNA determined that the contractor surpassed the in-house team. For both MC and FMC rates, it took the contractor 29 months before rates began to improve. (Tighe, 1997)

Third, cost savings were sustained or increased with subsequent contracts even when there was a change in contractors. These savings resulted from the contractor using fewer resources than the in-house team. During the initial 15 months of the contract, the contractor had to cope with the effects of a learning curve. CNA utilized Direct Maintenance Man-Hours (DMMH) per flight hour to determine efficiency and that while DMMH rates were increasing for the contractor, they were still below the in-house team rates. Efficiency significantly increased even though the contractor employed fewer personnel. (Tighe, 1997)

Fourth, the reason that productivity increased after the break-in period was due to the fact that contract employees remained in place and can take advantage of the effects of the learning curve. Members of the in-house Navy maintenance were rotated in and out of the command, which resulted in a steeper learning curve. (Tighe, 1997)

Lastly, CNA determined that there was no break-in period or learning curve associated with the change of contractors. This is directly attributed to the fact that for the most part, contract employees remained in place. Cost reductions due to increased efficiencies were realized. (Tighe, 1997)

3. Parris Island

This case highlights one of the few Marine Corps efforts in outsourcing and it was a failure. Between 1988 and 1992, two separate multifunction base operating supporting (BOS) contracts were in effect. The A-76 competition process leading to contract award lasted five years. The first contractor lasted three years before going bankrupt for reasons unrelated to Parris Island. The second contractor lasted 10 months before the government declared them in default and brought the functions back in-house.

The multifunction BOS contract contained functions that ranged from pest control to heating plant operations. One of the problems identified with the first BOS contract was that the PWS was incomplete. This led to problems in contractor performance. Another problem was the effect on employee morale that occurred during the five year A-76 competition process. It took an additional year for to contract start, which compounded the moral, and productivity problems with civilian workers. Once the contract award was announced, many of the most qualified workers left. Those that remained were not as productive, which created an unanticipated backlog of work for the contractor to assume at start date. (Tighe, 1997)

Both contracts resulted in problems with contractor use of government provided facilities; specifically, the steam-generation plant and the sewage treatment plant. Conflict arose between the government and contractors over the operation and maintenance of these facilities. The government maintained that the facilities were not being properly maintained or operated by the contractor. The first contractor claimed that the facilities required many improvements and upgrades which affected their ability to operate them. The second contractor failed to accurately document proper inventory

controls of spare parts for these facilities. This led to an adversarial relationship between the government and both contractors. In the end, all previously outsourced functions were brought back in-house.

The Davis-Bacon Act and the Service Contracting Act require contractors to pay wages set by the Department of Labor. (DOL) At the time Parris Island initiated the BOS contract, DOL wage rates were approximately one-third lower than the prevailing local wage for similar functions. Contractor bids were based on DOL wages, which made it difficult for the contractors to attract quality workers. The poor quality of workers ultimately led to some of the performance problems that affected the contractors. (Tighe, 1997)

Another area that affected the outcome at Parris Island was the use of sealed-bid contract process. This process limited the command to accepting the lowest bid for the BOS contract. The command did not have the ability to use contractor past performance when evaluating the bids. This limited the ability of the command to effectively screen out unqualified bidders. In effect, "you get what you pay for". (Tighe, 1997)

The Parris Island case is an example of a negative experience with outsourcing. However, there are valuable lessons to be learned that can be beneficial to MARFORPAC. This case demonstrates that there is a learning curve for the government. The first BOS contract relied on poorly written performance work statements. Parris Island learned from this experience and provided a more complete PWS for the second BOS contract. The second BOS contract also included penalties for non-compliance. Another aspect of this case is that bundling many functions into a single multifunction BOS contract can lead to problems if all the functions do not fit well together. The case

also points out the importance of good negotiations when it comes to contractors utilizing government-owned facilities. The negotiations must be detailed enough to indicate responsibility for upkeep and maintenance of these facilities.

4. U.S. Army Outsourcing

The U.S. Army has conducted outsourcing competitions for multifunction contracts that also provide learning opportunities for the Marine Corps and MARFORPAC.

Fort Eustis, Virginia is a command that falls under the Army Training and Doctrine Command (TRADOC). A multifunction competition was conducted for services that included laundry, food services, supply, transportation and maintenance. The command at Fort Eustis was pleased with the performance of the contractor, which has been in effect since 1982. Initially, there was some cost growth associated with the contract, that has been attributed to the DOL wage rate increases and changes in the scope of work. Since these initial cost increases, changes to the scope of work have been carefully documented and costs for the contract are declining. The command is extremely pleased with the flexibility shown by the contractor. They believe that the contractor is able to cope with changes better than the original in-house team. (Tighe, 1997)

A key component in this contract is the working relationship that the contractor and the command share. This has provided many benefits to the command. One is the responsiveness of the contractor. An example cited was the surge operations during Desert Shield/Storm, that required the repainting of more than 1,000 vehicles. This task was completed on time and within scope because the contractor was able to quickly adapt and expand the workforce to meet the increased workload. This relationship has allowed

the command and contractor to informally discuss changes and agree upon a mutually beneficial solution. (Tighe, 1997)

Another positive aspect is that the quality assurance (QA) plan used is realistic. The quality of contractor performance is based on realistic goals, and the command uses an award fee contract as an incentive to ensure good performance. In contrast, another unidentified installation under TRADOC experienced negative results with a similar contract with the same contractor. This was attributed to an unrealistic QA plan that required contractor performance to be superior to the "before study" in-house performance. (Tighe, 1997)

5. Lessons Learned/Summary

These cases represent a small portion of outsourcing experiences within DoD. Many lessons learned are unique to the individual case. Some of the lessons learned are similar to all. CNA reported that in almost every case there was a learning curve associated with the outsourcing process that resulted in an initial decrease in productivity. The learning curve tends to be steeper when the PWS is not complete. (Tighe, 1997) The most successful outsourcing efforts resulted when performance-based contracts were utilized with some type of award fee. Grouping similar functions into a multifunction study resulted in greater savings than competing single functions. Finally, employee morale may be affected during the process and the longer the A-76 process takes, the greater the impact.

These lessons learned can be beneficial to any command undertaking the A-76 process. The next section will analyze these lessons learned.

C. ANALYSIS AND INTERPRETATION

Outsourcing remains the vehicle for DoD to reduce costs and inefficiency. To adequately understand how the competition associated with outsourcing can be beneficial, the limits of the process must be explored.

1. Learning Curves

Basic learning curve theory states that a worker learns as he or she works, and the more often the same operation is repeated, efficiency will increase. The Navy experienced this phenomenon when outsourcing TA-4 maintenance. Understanding learning curve theory will benefit the command when determining which functions to outsource. The more technically intensive the function, the more time it will take to overcome the learning curve.

The Parris Island case indicates that learning also occurs on the part of the installation. This case demonstrates how poorly written PWSs can negatively impact the outcome. The negative impacts tend to last the length of the first contract.

For a contractor to win the bidding process, the winning bid must be 10 percent lower than the in-house bid. This 10 percent margin is designed in part to account for the short term disruptions that may occur as a result of changing service providers. (Kettl, 1993) In the Navy case, the short-term disruption lasted over two years before an improvement was recorded. A steep learning curve that is the result of poor PWSs will increase the risks for the government. While all risks can't be controlled, the government must do all it can to mitigate them.

2. Poor PWS Development

Development of the PWS is critical to the A-76 process. As indicated in Chapter II, having in-house employees develop the PWS is disruptive and leads to decreased productivity. Poorly written PWSs result in cost escalation as the scope of work is changed to reflect the work that is required of the contractor.

Within DoD today, many commands are faced with not having the knowledge base to conduct effective outsourcing competitions. This is the case partly because many of the individuals who had the requisite knowledge have left government employment. This will increase the risk for the command initiating the A-76 process.

The potential savings associated with outsourcing can quickly be reduced as a result of a poorly written PWS. To prevent cost escalation, commands must design the PWS to effectively capture the essence of the function considered for outsourcing. A PWS for a simple task should be very specific so there is no question as to what is expected from the contractor. For more complex functions, the PWS should be written to identify outcomes desired by the government without telling the contractor how to complete the task. A well-defined PWS is the key to meeting the requirements for effective performance and preventing excessive contract modifications and unanticipated cost increases.

3. Contract Type

The type of contract that is awarded can also impact the success of the outsourcing effort. The cases outlined above indicate that using negotiated competitions that take into account bidder past performance can increase the likelihood of success. The Parris Island case provides an example of the downside of the sealed-bid process. The

following discussion will look at the different types of contracts that are typically used in the outsourcing process.

a) *Firm-Fixed Price Contract*

As the name implies, a firm-fixed price contract provides a contract with a price that is fixed for the life of the contract and is not subject to any adjustment relative to the costs incurred by the contractor. The contractor accepts all the risk while the government does not share in any of the risk. Profit for the contractor is directly related to the cost of doing the work. In other words, how effectively the contractor controls cost and manages the contract will determine the amount of profit. (Hearn, 1996)

Under this type of contract, the government relies on competition and profit motive to motivate the contractor to be efficient and make accurate decisions regarding contract fulfillment (Thompson and Jones, 1994). Fixed price contracts have been used in instances where the service provided was labor intensive and contracting officials and bidders could accurately estimate costs.

b) *Cost-Type Contracts*

This type of contract utilizes cost reimbursement. The government agrees to reimburse the contractor for all allowable and allocable costs incurred in the execution of the contract. This type of contract places more risk on the government in terms of escalating costs. (Hearn, 1996)

c) *Award-Fee Contracts*

The award fee can be used in either type contract. It is typically used in the cost-type contract. The award is used as an incentive to encourage maximum

contractor performance. It is used to provide incentives in areas such as timeliness, quality and cost effectiveness. It is awarded based on the government's subjective determination of the contractor performance. (Hearn, 1996)

The award-fee type contract has proved beneficial to commands as a means for containing or reducing costs. The award provides the command with a means to focus the contractor on feedback from the recipients of the service and can result in better responsiveness from the contractor. (GAO, 98-82)

4. Contract Monitoring

Regardless of the type of contract used in the outsourcing process, the performance of the contractor will have to be monitored. Monitoring of the contract should be preventive not punitive. The intent is to determine whether discrepancies exist between the provisions of the contract and actual results. (Prager, 1994) The firm-fixed price contract requires less administrative overhead than the cost-type contracts. Monitoring contracts incurs additional costs to the government, but the costs of not monitoring can be even greater.

Monitoring contracts where the contractor has more opportunities to defraud the government is more critical. In the case of the cost-type contract, the government must approve the costs submitted. This requires a knowledgeable staff and can lead to creation of a separate bureaucracy for contract monitoring. As the requirements for effective monitoring increase, so do the costs. The costs associated with monitoring the outsourcing contract can exceed the costs of producing the service in-house, thereby reducing savings. (Prager, 1994)

Contracts with the private sector require monitoring to ensure that the government is provided the service or product it has purchased. The costs of monitoring must be considered when analyzing the costs of outsourcing.

5. Best Value Criteria

Best value refers to the process of selecting the most advantageous offer to the government by evaluating and comparing factors in addition to price and cost. It allows the government to choose the superior bid even if it means paying a higher price. The use of best value criteria also allows the contracting agency to avoid selecting the lowest bidder if they believe that the lowest bidder is not capable of effectively executing the contract. Best value criteria are considered appropriate when the functions assessed for outsourcing are complex, require technical expertise and where there is a high level of risk involved.

Experience has shown that the low bidder will tend to focus more on profit and quality may be sacrificed. As indicated in the Parris Island case, this situation can be costly to the government when contracts have to be modified or a new contractor has to be found as a result of contractor failure.

6. Bundling of Functions

Grouping similar functions together into a single, omnibus contract has produced benefits. The benefits include 1) a single manager is held responsible for performance; 2) greater opportunities exist for efficiencies; 3) increased flexibility for contract change; and 4) reduced cost and effort involved in developing and awarding a single contract. (GAO, 97-86)

Bundling of functions also provides the contractor flexibility to utilize the same employees across functions. This leads to increased efficiencies that help to contain costs over the long term.

Omnibus contracts are not without drawbacks. The contract can become cumbersome to manage effectively. The lack of expertise in all areas of the contract of those responsible for oversight can also lead to problems. Degraded quality in some functions can lead to problems affecting other areas. Also, when sub-contractors have a dispute with each other, functions can be put at risk that affect the mission accomplishment of the installation.

The potential for problems with omnibus contracts cannot be overlooked when contemplating outsourcing. The decision to bundle functions must be weighed carefully against the potential for problems, and the requirement for a knowledgeable staff to monitor performance.

7. Employee Morale

The outsourcing process creates problems for the employees and managers in the areas considered. As previously stated, once the announcement has been made to conduct an A-76 study, productivity may decline. The A-76 process is perceived as putting jobs at risk. Many employees transfer to other federal jobs. Key to successful completion of the outsourcing competition is communication.

Senior leadership from the installation must be involved from the beginning and support the process. This commitment sets the tone for the rest of the command. Adhering to the time frame in OMB Circular A-76 will also reduce moral problems. As

indicated in the Parris Island case, the longer the competition process lasts, the greater the potential for problems.

The command must communicate with its employees. Regardless of who wins the competition, the probability exists that some jobs will be lost. Informing employees of this possibility and assisting with a transition program can enhance employee morale. (Tighe, 1997)

The challenges associated with outsourcing also affect labor unions that represent federal employees. While unions generally do not support outsourcing, they realize that the A-76 process has been used as a means to reduce costs. Communicating with the employees and unions will provide the necessary information that will assist those affected by outsourcing to make more intelligent career decision. (Tighe, 1997)

D. SUMMARY

DoD has many experiences with outsourcing. Lessons learned from experience can be applied to the USMC outsourcing process that will prevent problems from occurring.

Understanding that there is a learning curve associated with the process will strengthen the government's ability to effectively estimate costs. Having accurate performance work statements will impact not only on the learning curve, but the contracting process as well. The more accurate the PWS, the greater the probability that problems will be decreased. The type of contract that is used is dependent upon the situation. If the function(s) to be outsourced are routine and manpower intensive, a firm-fixed price contract may be preferred. Functions that require changes in the workload or

cannot be adequately defined in the PWS are better suited for a cost-type contract. Utilization of an award fee contract has proved beneficial as an incentive to motivate the contractor. Best value criteria are key to successful contracting. The government must take into account previous performance of the potential contractors. Employee morale will be affected during the outsourcing process. Communicating with the employees and labor unions can produce a positive relationship that will enable a smoother transition regardless of who wins the competition process.

V. CONCLUSIONS AND RECOMMENDATIONS

A. INTRODUCTION

DoD has renewed its emphasis on outsourcing as a means for reducing costs and achieving savings that can be applied to modernization and procurement. The Marine Corps has been assigned its share of savings and, in turn, has charged commanders with meeting targeted savings goals. OMB Circular A-76 is the primary tool to be used to achieve these savings. MARFORPAC has developed and is in the process of implementing the Cost Reduction Initiative. The CRI is a long-term plan designed to meet the mandated savings through outsourcing and culture change.

In the current environment of fiscal constraint, outsourcing is viewed as a means to meet the QDR recommendation of \$60 billion in savings. Outsourcing of functions also is intended to cause the services to focus on core competencies to meet national security needs.

Benefits of outsourcing are identified as: 1) competition associated with outsourcing results in efficiencies; and 2) substantial cost savings will result from competition between and within the public and private sector.

Concerns with outsourcing voiced by opponents are: 1) projected savings may be overstated; 2) fraud and abuse may result from contracting out services; and 3) cultural resistance to change is difficult to overcome and this may impede outsourcing implementation.

A detailed description of the MARFORPAC CRI was provided. This included a discussion of the organization and the measures that are intended to be used at the overseas installations that cannot utilize OMB Circular A-76.

Finally, a review and analysis of lessons learned from actual contracting out resulted in the following conclusions: 1) there is a learning curve associated with outsourcing that may affect productivity; 2) an incomplete PWS will impact negatively the learning curve and the contracting effort; 3) the most successful outsourcing efforts resulted from the use of performance-based contracts; 4) the use of an award fee provided additional incentives to motivate the contractor to reduce or control costs; 5) bundling functions into a multifunctional study results in greater savings than several single function studies and contracts; and 6) employee morale may be adversely affected the longer the A-76 process takes to complete.

The purpose of this thesis has been to examine outsourcing and the MARFORPAC cost reduction initiative. The following sections answer the research questions posed in Chapter I and then provide some concluding recommendations and observations.

B. PRIMARY RESEARCH QUESTIONS

The primary research questions are: (a) What is the Marine Corps policy on outsourcing? (b) What are the lessons learned from commands that have completed the outsourcing process? (c) Is the strategy developed by the Commander, Marine Forces Pacific adequate to achieve the savings identified by HQMC?

Outsourcing in the Marine Corps is a tool in the revolution in business affairs designed to transform the culture in the Marine Corps to achieve the most efficient and effective organization. The A-76 process will be utilized to compete all commercial activities. All civilian and uniformed Marine service structure will be included in this process. Any Marine billet contracted out will be reduced from the end strength of the Marine Corps. The installation commander is tasked to determine which commercial activities to compete, based upon local considerations.

The lessons learned from other DoD outsourcing experiences were highlighted previously. The most important is the development of an accurate performance work statement. The PWS is the key to the process and will impact directly upon the success of the outsourcing effort. The more accurate the PWS, the fewer problems encountered by both government and contractors.

As of the publication of this thesis, it is too early to determine whether the CRI will result in the savings projected. Funds have been reduced from the O&MMC budgets of the MSCs for the out-years. The MSCs are currently determining which functions to outsource and the best ways to meet the specific savings allocated to them.

C. SECONDARY RESEARCH QUESTIONS

1. Definition of Outsourcing

Outsourcing is the transfer of functions that are traditionally done in-house to the private sector. This is typically accomplished through the use of the OMB Circular A-76 process. Outsourcing is based on the assumptions that (a) the government operates as a monopolist and is therefore inefficient, and (b) the private sector is inherently more

efficient because of competition in the market. The savings associated with outsourcing are the result of the competition between and/or within the public and private sectors.

2. Strengths and Weaknesses of Outsourcing

The benefits and concerns with outsourcing are noted above. Clearly, the greatest strength associated with outsourcing is the potential savings that result from reduced costs and increased efficiencies. Savings estimates range from 20 to 40 percent for commercial activities that involve civilian employees. When considering active duty military, the savings may be as high as 50 percent. These lucrative potential savings are one reason that DoD has renewed its emphasis on outsourcing as a means to modernize the force.

Associated with the potential savings is the concern that the estimated savings are overstated and will not be achieved. The services and mildeps are not required to maintain records of costs past three years. Based upon past experience, costs will continue to grow over time and anticipated savings will decrease. Past experience within DoD indicate that estimated savings associated with other reform initiatives have not been realized. The impact of personnel reductions, both civilian and military, may also affect the amount of savings realized. As the size of DoD shrinks, personnel that remain must become more efficient to accomplish the same tasks to support the force. The savings that are anticipated may become harder to achieve as organizations approach their most efficient level.

3. The Need for Outsourcing in the Marine Corps and MARFORPAC

To meet the demands of the 21st century, DoD must find ways to meet the expected \$30 to \$60 billion shortfall in modernization and procurement. The Marine Corps has had to sustain its operations and maintenance funding at the expense of

procurement and modernization. The challenge facing the Marine Corps is modernizing aging weapons systems and facilities in an era of reduced resource availability. The Marine Corps anticipates saving \$215 million between FY 2000 to FY 2003 and \$110 million thereafter through outsourcing. These savings are to be applied to modernization.

MARFORPAC has been assigned its share of the savings wedge. Between FY 2000 to FY 2005, MARFORPAC will "contribute" \$150 million towards the Marine Corps wedge. MARFORPAC developed the CRI as a means to realize these savings and revolutionize the way business is conducted. The CRI encompasses both the supporting establishment and the operating forces in this effort.

4. Issues Affecting MARFORPAC

MARFORPAC is faced with implementing and sustaining a program with minimal technical expertise. Re-engineering business consultantation provided by NAVFAC will assist the installation commander in implementation. The initial absence of sufficient personnel trained in the outsourcing area may adversely impact implementation. Integration of lessons learned in the initial outsourcing effort will be crucial for subsequent efforts.

Development of accurate performance work statements will affect this process. An improperly conceived PWS may be detrimental to the success of the local effort to implement the CRI. Relying on civilian employees to develop the PWS may be the only option available, but this poses potential risks to the Corps in terms of sustaining mission capability that must be managed.

Determining whether to bundle functions into a single study and contract or conduct numerous single studies and let multiple contracts will affect the amount of

savings that can be achieved. Each installation and outsourcing effort is unique and these decisions must be reached at the local level. Having some installations utilize a BOS type contract and others utilize single contracts will affect the overall savings that MARFORPAC will realize.

Another issue is the implication of reducing the civilian workforce. An effective program, in line with any union agreement, to inform employees of impending outsourcing initiatives will be beneficial. Adhering to the goal of using normal attrition and placement programs will minimize adverse impacts from job loss.

Another issue that will effect MARFORPAC is determining the type of contract to issue. Using a fixed price or cost plus contract depends on the type of function(s) to be competed. Most functions associated with base support can be bid on a fixed price contract because they are well defined. The use of the award fee approach provides an incentive to the contractor to control costs. However, the use of an award fee creates additional overhead costs to the government in the form of oversight costs.

5. Impacts of Outsourcing on MARFORPAC

When the installation commander announces an A-76 study, there may be an initial decrease in the productivity of civilian employees. This may occur due to the uncertain future that faces the employees, and must be anticipated by the command.

D. ADDITIONAL OBSERVATIONS ON OUTSOURCING

Including military manpower in outsourcing studies may have unforeseen consequences for MARFORPAC. The stated policy is to compete Marine billets and to reduce end strength if the billet is outsourced. Many of the billets that will be considered

are typically considered non-Fleet Marine Force (FMF) billets. Some non-FMF billets are used to keep Marines proficient in their MOS without having to deploy. A reduction in the number of non-FMF billets will mean a corresponding increase in the amount of time that a Marine spends in the FMF. The downside to this is the possibility that morale may be adversely affected as a result of an increase in operations and personnel tempo.

Politically, all this places the Marine Corps in a difficult position. The Commandant and his predecessors have lobbied extensively to keep the end strength of the Marine Corps stable. Congress and the QDR have agreed with this position. If the Marine Corps would be willing to reduce military end strength as a result of outsourcing, this could adversely affect Marine Corps credibility.

To compensate for the problem, in November 1998, HQMC removed military manpower from the outsourcing process. This change will require that the assigned savings be obtained from conducting A-76 studies involving the civilian workforce. This creates new challenges for MARFORPAC, as more emphasis will have to be placed on savings from process improvements.

E. CONCLUSIONS

Outsourcing is currently viewed as one remedy to reduce the costs associated with operating the DoD infrastructure. Outsourcing alone cannot provide the cost savings and efficiencies required. However, the competition associated with outsourcing is the means by which the government may obtain cheaper services and increased efficiency. It appears to be a step in the right direction in adopting better business practices.

Experiences from previous outsourcing efforts indicates that the process can be successful if the following considerations are taken into account during the outsourcing process:

- Develop accurate performance work statements that reflect the essence of the function without providing specific details on how to accomplish the task.
- To the extent possible, utilize multifunction studies that incorporate similar functions or allow for the use of employees across functions.
- Utilize best value criteria when selecting a contractor.
- Ensure that command commitment is promulgated and maintained during transitions of commanders.
- Communicate with employees and their unions from the start of the process and establish an effective transition plan for in-house workers.

The MARFORPAC CRI is a broad-based approach to achieving the savings required to meet modernization needs. The future success of the CRI will, in part, be based on the political and fiscal environment of the 21st century. MARFORPAC has set the standard for the Marine Corps and has developed a plan that can be altered to meet changing fiscal constraints.

F. AREAS FOR FURTHER RESEARCH

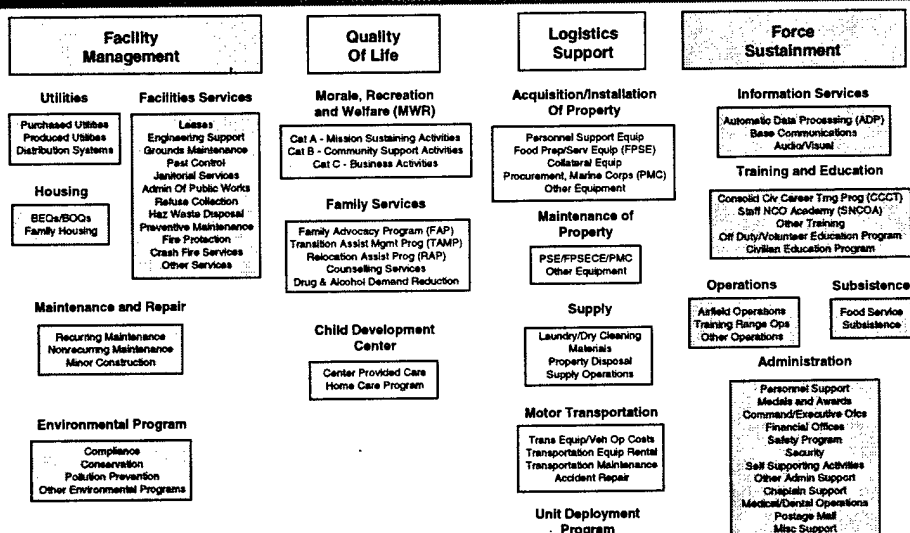
This thesis examined outsourcing and the MARFORPAC Cost Reduction Initiative. Additional research is required on implementation problems and lessons learned from the various MSCs. Fiscal data are needed to determine to what extent the savings projected have been met and whether and how the reduced O&MMC budget affects the readiness of the Marine Corps.

APPENDIX

MARFORPAC CORE BUSINESS MODEL

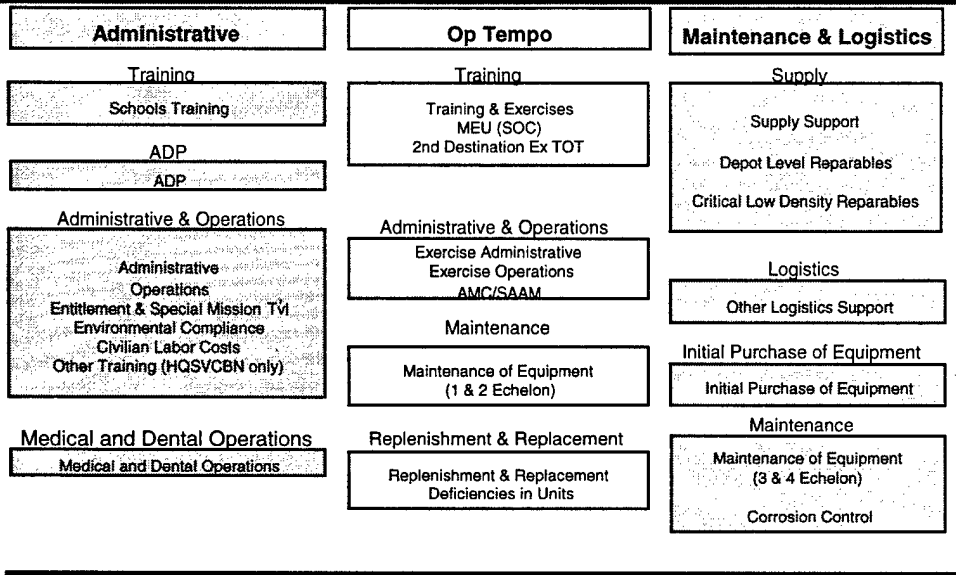


Bases/Stations Functional Model





Operating Forces Core Business Model (Revised)



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